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DE RUEHCP #0024/01 0091401
ZNR UUUUU ZZH
R 091401Z JAN 09
FM AMEMBASSY COPENHAGEN
TO RUEHC/SECSTATE WASHDC 4710
INFO RUCNMEM/EU MEMBER STATES
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 02 COPENHAGEN 000024

SENSITIVE
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DEPT FOR EEB/IFD/OMA AND EEB/EPPD.
TREASURY FOR VIMAL ATUKORALA

E.O. 12958: N/A
TAGS: ECON EFIN DA
SUBJECT: DANISH ECONOMY TREADING WATER IN A CHOPPY SEA

REF: A. 08 COPENHAGEN 540 (BANK SAFETY NET PLAN)
¶B. 08 COPENHAGEN 574 (DOWNBEAT ON ECONOMY)
¶C. 08 STATE 134459 (REPORTING ON FINANCIAL CRISIS)

¶1. (SBU) Summary. One of the first EU nations to slide into recession in 2008, Denmark absorbed many of the same economic body blows felt by other OECD nations and is braced for what is expected by all forecasts to be a bleak 2009. Due to relatively prudent pre-crisis lending practices and a timely October 2008 public/private "bank safety net" program that guaranteed all bank deposits, the Danish financial sector is generally sound but cautious (business groups say excessively cautious) about new lending. In order to spur new lending, the Danish government is considering the injection of public finds into private banks. The initiative has been dogged by lack of consensus over whether private banks need -- or even want -- public money, and whether the banks will lend the money in a manner envisioned by the government. Denmark's leading stock index gave back nearly half of its value in 2008, real estate values have plunged, and economists predict that Denmark's budget surplus will likely vanish in 2009. The Danish government's machinations to protect its semi-battered, euro-pegged krone and a disparity in interest rates between Denmark and the EU have helped re-fuel public debate about euro adoption. Denmark's jobless rate is still among Europe's lowest, but analysts forecast that continued economic contraction throughout 2009 may double the current unemployment rate of 1.9 percent by year's end. End Summary.

## Banking Sector: Sound Banks Skittish about New Loans

¶2. (SBU) After absorbing losses in 2008 that caused one major bank to crash into insolvency and several other troubled banks to merge, the Danish banking sector is reportedly in relatively sound overall financial health, though the value of publicly-traded bank shares has plummeted precipitously in the last five months. Observers attribute the sector's relative stability to two major factors. One, pre-crisis bank lending practices were generally prudent in comparison to those exercised by many U.S. banks, particularly in real estate and construction financing; and two, a bank "safety net" plan financed jointly by banks and the Danish government to provide unlimited guarantees on bank deposits, a bold and decisive measure taken early in last autumn's global financial meltdown that went far to allay public panic and avert a possible run on banks (Ref A).

¶3. (SBU) As in the U.S. and elsewhere, however, Danish borrowers are experiencing a tight credit market as banks have grown more cautious in lending over the past several months. A variety of interlocutors attribute the current credit crunch more to psychological rather than purely economic factors. Jan Olsen, a senior executive of Danske Bank, Denmark's leading financial institution, told us that "nobody trusts anyone else right now, banks don't trust other

banks and they don't trust their customers like they once did." Olsen acknowledged the frustration of the Danish private business sector over the tightness of credit (according to the Confederation of Danish Industries, over one-third of all Danish businesses are reporting difficulty in obtaining new financing), but claimed that such complaints are exaggerated and ill-founded. Olsen insisted that his bank and other lenders are still making new loans at relatively low interest rates -- for example, the current interest rate for a 30-year mortgage is below 5 percent -- but lenders are far more meticulous and exacting in review of loan proposals than they were in the recent past. As Olsen stated, "we are now doing business like we did ten years ago, not two years ago, and the process takes a lot of time and documentation." The Danske Bank executive admitted that loans to the information technology sector have ceased, not due to perceived greater-than-normal sector volatility but rather because of a recent scandal surrounding Stein Bagger (a flamboyant rogue software entrepreneur with a taste for body-builder mistresses and Hell's Angel bodyguards), who allegedly bilked Danske Bank and other investors out of as much as USD 250 million.

¶4. (SBU) In order to grease the lending skids, the Danish government is engaged in discussions with parliament and banking sector representatives over a proposal to inject public funds into the private banking sector. In a January 7 roundtable meeting hosted by the Ambassador for Prime Minister Anders Fogh Rasmussen and the board of the local American Chamber of Commerce, Rasmussen emphasized that the plan was designed strictly to spur bank lending, not to prop up banks. Progress on the liquidity injection initiative has



been slow due to a lack of consensus on whether the banks actually need (or even want) public funds, and whether an injection of public money will indeed lead to increased lending by private bankers. Observers report that parties to the discussion are examining closely the impact of steps taken pursuant to the U.S. Emergency Economic Act of 2008 in an attempt to glean lessons learned. Danske Bank executive Jan Olsen told us his bank and other major banks are already able to obtain all the money they need on the open market, do not particularly want an injection of public funds, and will likely maintain current lending practices even if public money is provided to them. In possible anticipation of continued bank stodginess, Prime Minister Rasmussen told the AmCham board that his government will pursue a more direct economic stimulus package if the bank liquidity injection plan does not achieve a desired result. Repeating a theme that came up in his New Years Day speech to the nation, Rasmussen also said his government would seek to enact major cuts in personal income tax rates by the end of the year in order to promote work and productivity, but he conceded that the tax reduction proposal will face stiff opposition in parliament.

## Dwindling Budget Surplus, Rising Joblessness

¶5. (SBU) In 2008, Denmark was one of the first EU countries to fall into a technical recession, and three consecutive quarters of GDP contraction have taken a toll on the Danish current account. Denmark's once-enviable budget surplus (about 5 percent of GDP from 2005 to 2007) has dwindled, and economists are predicting that Denmark will likely soon see its first budget deficit since the mid-1990s due in some measure to drops in global oil prices and maritime shipping rates, two of Denmark's major income sources. In the second half of 2008, the Danish krone depreciated as much as 24 percent against the U.S. dollar before a late-year rebound of about 6 percent. Even though the Danish krone is tied to the euro, the Danish Central Bank has been obliged to protect the krone against speculation through a series of interest rate hikes and cuts independent of those by the European Central Bank. The central bank interest rate now stands at 3.75

percent after a reduction in late 2008, and is reportedly among the highest rates in Western Europe. The efficacy of the krone/euro peg and the disparity in central bank interest rates between Denmark and te euro zone have combined to re-ignite debate witin Denmark about the advantages of euro adoption Speaking for what is reported to be a growing umber of euro adoption advocates, leading Danish economist Steen Bocian stted that Denmark "currently enjoys neither the avantages of being part of the euro nor the advantaes of having an independent currency." Althoughthe Danish electorate has twice rejected euro adotion, most recently in a 2000 referendum, the Ramussen government is reportedly exploring the posibility of holding yet another euro referendum ater this year.

¶6. (SBU) For most of this decad, Danes have been able to boast of historically-low unemployment rates, and Danish businesses complained loudly of a lack of available labor. While Denmark continues to suffer from a shortage of highly-skilled workers in certain sectors (a point emphasized by AmCham members in their January 7 roundtable meeting with the Prime Minister at the Ambassador's residence), the salad days of "structural full employment" in Denmark appear to be over. According to Danish government statistics, Denmark experienced 3,856 personal and business bankruptcies in 2008, the highest total since 1996, and economists have extrapolated that bankruptcies resulted in a loss of 19,000 jobs last year. While Denmark continues to have one of Europe's lowest jobless rates at about 3.4 percent (EU defined rate -- as defined under the Danish government's statistical methodology, the rate is 1.9 percent), this figure is expected to rise significantly in the coming year. Denmark's National Economic Council has forecast continued negative growth throughout 2009 and total unemployment of around 100,000 by the end of the year, almost double the current figure of 52,000 jobless Dames. Denmark's C20 index of leading blue-chip companies followed the global trend of stock market setbacks in 2008 by losing nearly 50 percent of its value. Real estate values have fallen throughout Denmark, and the current property market is full of sellers and few buyers.
CAIN